Introduction to SECNAVINST 5800.15, “Use of Binding Arbitration for Contract Controversies,” 5 Mar 07

DON ADR Program Office

Overview

- SECNAVINST 5800.15 authorizes contracting officers to use binding arbitration to resolve contractual issues in controversy.
- Binding arbitration is an alternative dispute resolution (ADR) procedure that can be faster and less costly than other forms of adjudication.
- Binding Arbitration should be considered at the inception of an issue in controversy.
- Binding Arbitration is a tool that complements other procedures.

We will discuss:

- Key Concepts
- Why use Binding Arbitration?
- Source of Authority
- Basic Policy
- Guidance:
  - Parties
  - Decision to Use
  - Arbitration Agreement
  - Arbitrators
  - Hearings
  - Awards
  - Court Review
- Creative Approaches

Preface - Key Concepts

- **“Binding Arbitration”** - An alternative dispute resolution process that refers a dispute to a third party neutral who, after giving parties an opportunity to present evidence and arguments, renders a determination in settlement of the dispute. The neutral’s authority derives from contract rather than administrative or judicial authority.
- **“Mediation”** - An alternative dispute resolution process wherein a neutral assists the parties in reaching a negotiated settlement agreement.
- **“Issue in Controversy”** - a material disagreement between the Government and the contractor that—
  (1) May result in a claim; or
  (2) Is all or part of an existing claim. (FAR 33.201)
- **“Arbitrator”** - A neutral, selected by the parties, who conducts an arbitration and issues an award. Not an “arbiter.”
- **“Award”** - The decision issued by an arbitrator. Can also refer to the relief granted by the arbitrator. Technically not a “judgment.”

I. Why Use Binding Arbitration?

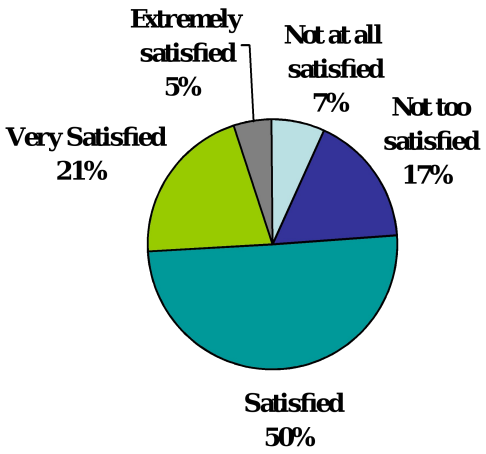
- The Office of Federal Procurement Policy's (OFPP) 2002 ADR Award recognized the FAA's binding arbitration policy.
- American Arbitration Association (AAA) sponsored a survey[1] of 253 corporate legal departments. The top five applicable* reasons why corporations use arbitration:
  - Saves money
  - Saves time
  - More satisfactory process
  - Allows party control
  - Has limited discovery
- 84% of the surveyed companies used it for commercial contract disputes.

* "Required by contract" is another, but 5 U.S.C. 575 prohibits making binding arbitration a condition of award of a Government contract.

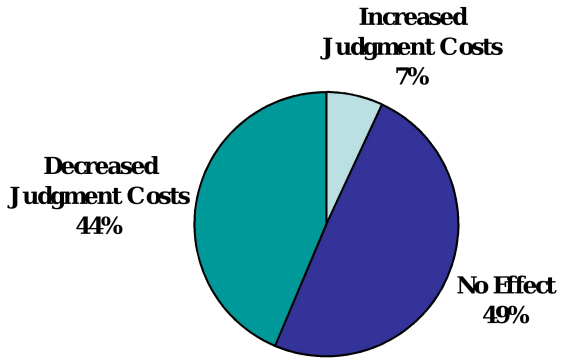
FN 1 - *American Arbitration Association, Dispute-Wise Management: Improving Economic and Non-Economic Outcomes in Managing Business Conflicts, p. 9.*

Why Use Binding Arbitration?

77% of AAA surveyed companies were satisfied with arbitration:



94% reported reduced judgment costs or no adverse effect when using arbitration:



Source - American Arbitration Association, Dispute-Wise Management: Improving Economic and Non-Economic Outcomes in Managing Business Conflicts, p. 20.

Procurement ADR Process Savings

- GAO offers ADR, but it is already fast and relatively informal.
- ASBCA offers mediation, binding summary trials, and other methods.
- DON avoided about $3M in process costs from FY01 to 05 in 41 cases surveyed.

- Not all avoided costs can be quantified.
- Does not include substantial costs for major documents th
dr

Non-Quantified Costs Avoided: Documents not Written	
Pleadings	7
Discovery Requests	17
Motions	13
Other Documents	4
Briefs	29
Total	70

Comparison to CDA Process

Contract Disputes Act

- Claim a prerequisite
- COFD required
- Appeal required
- Rule Four file standard
- Rule 11: paper hearing
- Rule 12: Accelerated options
- ADR Options
- AJ presides

ADRA Arbitration

- Can be before a claim
- Eliminate the COFD
- Eliminate the appeal
- Streamline process through:
  - controlled discovery
  - informal hearing
- Broader neutral choices
- Limited Review

Anticipated Uses

- Small claims
- Technical Issues
- Issues requiring rapid resolution:
  - To clarify obligations in long term contracts
  - To avoid accumulation of similar claims
  - To mitigate project delay or time related damages
- Incorporated into a Dispute Review Board

II. Source of Authority

- Administrative Dispute Resolution Act of 1996 (ADRA) – 5 U.S.C. § 575.
- FAR § 33.214(f).
- Both require Head of Agency to issue a guidance document after consultation with the Attorney General (AG).
- AG signed off on December 8, 2006.
- DON Notice published on 20 March 2006, at 72 Fed. Reg. 13094 (2007).

III. The Basic Policy

- SECNAVINST 5800.15 consists of a basic instruction, with a nine page guidance document.
- The policy, at ¶ 4, authorizes contracting officers to use binding arbitration, subject to:
  - Their usual authority & limitations to settle a claim;
  - Limitations contained in the guidance; and,
  - The approval of the AGC (L) in consultation with AGC(ADR).

Using Binding Arbitration: Oversight & Limitations

Strong Oversight:

- Contracting Officers may act only within their warrants.
- Each use is subject to the approval of senior OGC attorneys.
- Attorneys represent the DON.
- Parties control the selection of the arbitrator.
- DON will monitor the performance of arbitrators.

Limitations

- Statutorily required cap on monetary awards.
- Instruction prohibits agreeing to awards of:
  - punitive, consequential, special or exemplary damages
  - attorneys fees and costs.
- Statute prohibits awards that violate limitations imposed by federal statutes.

IV. The Guidance

- The enclosure to SECNAVINST 5800.15 provides guidance on structuring an arbitration procedure.
- The guidance has internal citations throughout, promoting understanding of statutory bases of the guide.
- The following slides highlight key concepts in the guidance.

IV.A. Parties

- Parties are essentially the same as found in the CDA.
- Subcontractors must obtain prime sponsorship.
- OGC attorneys will usually represent the DON.
- JAG attorneys may represent the DON if approved by AGC(L), after demonstrating sufficient experience in government contract law.
- Similar to NMCARS appeal procedures, the command should maintain the contract team that is familiar with the issue.

IV.B. Decision to Arbitrate

- Under SECNAVINST 5800.*13A*, the DON's policy is to use ADR to the maximum extent practicable, at the earliest stages.
- Binding arbitration is voluntary.
- Contracts cannot have a mandatory arbitration clause at time of award. Results in "ad hoc arbitration," rather than "permanent arbitration."
- Consider not using it for the six reasons under 5 U.S.C. § 572(b), plus if the matter pertains to fraud, or is outside the scope of the instruction.

IV.C. The Arbitration Agreement

- Permanent arbitration typically has an arbitration clause that references a provider (e.g., AAA) who has a published set of rules.
- Ad hoc arbitration uses a supplemental agreement that:
  - Serves as an accord and/or settlement agreement;
  - Defines issues to submit to an arbitrator;
  - Defines the arbitration process; and,
  - Establishes limitations on awards.
- The arbitration agreement MUST establish a cap on the maximum award that may be issued.
- The agreement MUST ELIMINATE authority to award:
  - Costs and attorney fees; and,
  - Punitive, consequential, exemplary or special damages.
- The agreement should establish a schedule (next slide).

Schedule Considerations

Current Process

- Issue impasse
- Claim Filed
- Contracting Officer review and final decision (COFD)
- *De novo* appeal to ASBCA or COFC. Compulsory discovery and relatively formal hearing
- Appellate review of law & factual basis

Binding Arbitration Process

- Issue impasse
- Agree to arbitration
- Limited discovery & hearing, followed by arbitrator's award
- Dist. Ct review on very narrow grounds

Arbitration processes should be shorter than, or equal to, a COFD review period on similar issues.

Arbitration eliminates the COFD, reduces discovery and hearing burdens, and greatly limits appellate review.

IV. C. Arbitration Agreement (cont.)

- The agreement should define:
  - The scope of discovery;
  - The date and length of the hearing, if any; and,
  - The expected level of briefing.
- Keep in mind that agreements can not cover everything. The arbitrator should have the authority to decide issues arising out of the agreement itself.
- An agreement can address confidentiality, but do not expect too much.

IV. D. Arbitrators

- The parties must agree on the neutral.
- ASBCA judges are available.
- But consider the advantages of a technical expert:
  - Save on expert witness costs;
  - Technical issues need technical background.
- In theory they can have a conflict of interest.
- Arbitrators have the authority to:
  - Regulate the conduct of the hearing;
  - Administer oaths;
  - Order attendance of a witnesses and production of documents under control of a party, including sponsored subcontractors;
  - Issue awards.
- Arbitrators MUST interpret and apply relevant statutes, regulations, legal precedents and policy directives.
- Unlike mediation, ex parte communications are not permitted, and can result in an adverse award.

IV. E. Hearings

- Any party is entitled to make a record.
- Parties are entitled to present evidence and be heard. But consider process savings from:
  - Waiver of live hearing (i.e., have paper hearing)
  - Use of affidavits or declarations; and,
  - Use of deposition transcripts.
- Arbitrators have discretion regarding the weight they give the evidence. Clearly, evidence tested by cross-examination should be treated differently from untested statements.

IV. F. Awards

- Awards shall briefly discuss factual and legal bases for award, but formal findings of fact, and determinations of law are not required.
- Forget the Secretary Veto Rule. That's old school, pre-1996. See ADRA of *1990*.
- Awards are final and binding on the parties.
- Awards do not establish legal precedent of general applicability, nor can they be used for collateral estoppel.
- Awards can be cited as precedent and for res judicata *in factually related proceedings*.
- Awards should be incorporated into the contract as a modification, and can be invoiced (or recouped) as usual.

IV. G. Review

Federal Arbitration Act (FAA)

- Agreements to arbitrate enforced under 9 USC § 4.
- 10 USC § 9 can be used for "confirmation."
- 10 USC § 10 has the standards to vacate an award:
  - Fraud
  - Evident partiality
  - Misconduct in scheduling or refusing to consider evidence
  - Exceed powers
- 10 USC § 12 provides 3 months to file for review.

ADRA Amendments to FAA

- A third party may challenge the use of arbitration if it can show that one of the six factors in 5 USC 572 apply. See 9 USC § 10(c).

ADRA Amendments to CDA

- Review is under FAA, but the court "may set aside or limit any award that is found to violate limitations imposed by Federal statute."

V. Creative Approaches

- Binding arbitration may be used with other methods:
  - Med-Arb or Arb-Med
  - Baseball Arbitration
  - Night Baseball Arbitration
- Arbitrators can be technical experts. This is a chief difference and advantage from ASBCA ADR.
- No limit on the number of neutrals. Can use one or three.
- Use to foreclose issues early and avoid repeated mistakes:
  - Example: Price Adjustment Clauses.
- Use for IDIQ contracts with high transaction rate:
  - Create a standing panel with authority to quickly arbitrate the issues submitted.

Binding arbitration is attractive when…

- … a contracting officer must write a “final decision” that won’t be final.
- … the cost of CDA processing exceeds the amount at issue.
- … an issue will surface repeatedly through the life of the contract.
- … the parties are at odds over the question of, “Whether austenitic steel forgings and bars examined in accordance with SA-388 satisfy the examination requirements of NB-2542.1, NG-2542.1, or WB-2542.1, as incorporated by reference under the subject contract.” This especially true if:
  - The work has not yet been performed;
  - Examination methods greatly increase cost; and,
  - Rework would cause substantial delay and greatly increase cost.

VI. ADR Program Training

- AGC(ADR) tasked to develop recommended procedures and forms.
- AGC(ADR) shall also provide training:
  - 3-hr Procurement ADR Course to be offered;
  - 8-hr Binding Arbitration Course to be offered.

Contact the ADR Program

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